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TY:

### Legend

Shareholder 1 =

Shareholder 2 =

Shareholder 3 =

Trust =

FC =

State =

Activity A =

Activity B =

Activity C =

Exchange A =

Exchange B =

Exchange C =

Index =

Country A =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5                =  
Year 6                =  
Year 7                =  
Date 1                =  
Date 2                =  
Month X               =  
Date 3                =

Dear                :

This is in response to a letter received by our office on October 2, 2020 submitted by Shareholder 1, Shareholder 2, and Shareholder 3 ("Shareholders") requesting consent to revoke mark-to-market elections ("MTM elections") under section 1296 pursuant to Treas. Reg. § 1.1296-1(h)(3) with respect to their investments in FC.

The rulings contained in this letter are based upon information and representations submitted by the taxpayers and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

## FACTS

Shareholder 1, Shareholder 2, and Shareholder 3 are each a separate series of Trust, which is organized under the laws of State and registered as an open-end management company under the Investment Company Act of 1940, as amended. Shareholders are each treated as regulated investment companies (RICs) under subchapter M of the Internal Revenue Code.

Shareholder 1 is a RIC that invests mainly in the domestic and foreign equity securities of companies that participate in Activity A, including companies that are passive foreign investment companies (PFICs) within the meaning of section 1297. The stock of Shareholder 1 is listed on Exchange A.

Shareholder 2 is a RIC that invests primarily in domestic and foreign equity securities that participate in Activity B, including companies that are PFICs within the meaning of section 1297. The stock of Shareholder 2 is listed on Exchange A.

Shareholder 3 is a RIC that seeks to provide investment results that closely correspond to the performance of Index, which is an index designed to track movements of Country A companies whose main business operations focus on Activity C, including companies that are PFICs within the meaning of section 1297. The stock of Shareholder 3 is listed on Exchange B.

In connection with their ordinary course investment operations, Shareholders have each purchased multiple lots of stock in FC, which is a non-US company listed on Exchange C. Shareholder 1 first purchased FC stock in Year 1. Shareholder 2 and Shareholder 3 each first purchased FC stock in Year 3. While FC was not a PFIC for its taxable years ending on December 31, Year 1 or December 31, Year 2, FC was a PFIC for its taxable year ending on December 31, Year 3. Each of the Shareholders held FC stock on December 31, Year 3 and on the last day of their respective taxable years ending on Date 1, Year 4.

FC did not make available to its shareholders a PFIC Annual Information Statement ("Statement") described in Treas. Reg. § 1.1295-1(g)(1) and, therefore, Shareholders were not able to elect to treat FC as a "qualified electing fund" within the meaning of section 1295 ("QEF election") for the taxable year of each Shareholder ending on Date 1, Year 4, which was the Shareholders' first full taxable year in which FC was a PFIC. At all relevant times, each of the Shareholders, each of which is a RIC, offered for sale or had outstanding stock of which it is the issuer and which is redeemable at its net asset value. Therefore, the stock of FC constituted "marketable stock" within the meaning of section 1296(e) and Treas. Reg. § 1.1296-2(f) beginning with Shareholders' taxable year that began on Date 2, Year 3 and ended on Date 1, Year 4. Each Shareholder made an MTM Election with respect to its FC stock under section 1296 for the taxable year ended Date 1, Year 4.

FC was not a PFIC for its taxable year ended December 31, Year 4, but was once again a PFIC for its taxable year ended December 31, Year 5. For the taxable years of Shareholders ending on Date 1, Year 4 and Date 1, Year 5, each of Shareholder 1, Shareholder 2, and Shareholder 3 included amounts in gross income under section 1296(a)(1) or deducted amounts under section 1296(a)(2) (collectively, "MTM Inclusions"), as appropriate, and adjusted its basis in FC pursuant to section 1296(b) accordingly.

Since Year 3 when FC first became a PFIC, FC has changed its policy regarding Statements and has begun to issue Statements to its shareholders. As a result, other shareholders who initially acquired stock after FC changed its policy and have not made an MTM election with respect to the FC are able to make QEF elections. Shareholders would like to make QEF elections with respect to FC but cannot do so while their MTM elections are in effect. An MTM election can be revoked only with the consent of the Commissioner "upon a finding of a substantial change in circumstances" within the meaning of Treas. Reg. § 1.1296-1(h)(3).

In Month X of Year 6, Shareholders discovered that FC had changed its policy and, for the first time, was willing to issue Statements with respect to the taxable year of FC ending on December 31, Year 5. A few weeks later, the tax advisors for Shareholders informed them of the possibility of requesting a letter ruling to revoke their MTM Elections on the basis that FC's change in policy regarding issuing Statements was a "substantial change in circumstances."

Shareholders represent that, if the ruling requests are granted, they intend to file QEF elections for FC with their tax returns for the taxable year ended Date 1, Year 6.

#### RULINGS REQUESTED

Shareholders request the consent of the Commissioner to revoke their MTM Elections with respect to FC at the end of their taxable years ended Date 1, Year 5, with the following consequences:

- (1) Section 1296 ceases to apply to Shareholder 1, Shareholder 2, and Shareholder 3 with respect to FC beginning on Date 2, Year 5;
- (2) Pursuant to Treas. Reg. § 1.1296-1(f), solely for purposes of sections 1291 through 1298, Shareholder 1, Shareholder 2, and Shareholder 3's holding periods in FC are treated as beginning on Date 2, Year 5;
- (3) Provided Shareholder 1, Shareholder 2, and Shareholder 3 each makes a valid QEF election for FC for the taxable year beginning on Date 2, Year 5, FC is a "pedigreed QEF" within the meaning of Treas. Reg. § 1.1291-1(b)(2)(ii) with respect to Shareholder 1, Shareholder 2, and Shareholder 3; and
- (4) Each of Shareholder 1, Shareholder 2, and Shareholder 3's stock basis in FC includes the basis adjustments allowed pursuant to section 1296(b) and the regulations thereunder.

#### LAW

Section 1297(a) provides that the term "PFIC" means any foreign corporation if (i) 75 percent or more of the gross income of the corporation for the taxable year is passive income; or (ii) the average percentage of assets (as determined in accordance with section 1297(e)) held by the corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent. Section 1296(a) provides that, in the case of marketable stock in a PFIC that is owned (or treated as owned under section 1296(g)) by a United States person at the close of any taxable year, the United States person may elect to include in gross income the excess of the fair market value of the stock over its adjusted basis or, if the adjusted basis exceeds the fair market value of the stock, deduct the lesser of the excess or the unreversed inclusions with respect to such stock.

Under section 1296(e)(2), in the case of any RIC issuing stock that is redeemable at its net asset value, all stock in a PFIC which it owns, directly or indirectly, shall be treated as marketable stock for purposes of section 1296.

Under section 1296(b)(1), the adjusted basis of stock in a PFIC is increased by the amount included in the gross income of the United States person under section 1296(a)(1) with respect to the stock and is decreased by the amount allowed as a deduction to the United States person under section 1296(a)(2) with respect to the stock.

Section 1296(k) provides that the MTM election will apply to the taxable year for which it is made and all subsequent taxable years unless the stock ceases to be marketable stock or the Secretary consents to the revocation of the election, and Treas. Reg. § 1.1296-1(h)(2)(i) provides that a MTM election will apply to the taxable year for which the election is made and remain in effect for each succeeding taxable year unless the election is revoked or terminated pursuant to Treas. Reg. § 1.1296-1(h)(3).

Treas. Reg. § 1.1296-1(h)(3)(i) provides that a United States person's MTM election is terminated if (i) the PFIC stock ceases to be marketable; (ii) the United States person elects, or is required, to mark to market the PFIC stock under another provision of chapter 1 of the Code; or (iii) if the Commissioner, in the Commissioner's discretion, consents to the United States person's request to revoke its MTM election upon a finding of a substantial change in circumstances, which may include a foreign corporation ceasing to be a PFIC.

Treas. Reg. § 1.1296-1(h)(3)(ii) provides that, unless otherwise provided by the Commissioner, where a MTM election is revoked with the consent of the Commissioner, section 1296 will cease to apply beginning with the first taxable year of the United States person after the revocation is granted, unless otherwise provided by the Commissioner.

Treas. Reg. § 1.1296-1(f) provides that, solely for purposes of sections 1291 through 1298, if section 1296 applied to stock with respect to the taxpayer for any prior taxable year, the taxpayer's holding period in the stock is treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 applied.

Under section 1295(b)(1), a taxpayer may make a QEF election with respect to any PFIC for any taxable year of the taxpayer, and the election applies to all subsequent taxable years of the taxpayer with respect to the PFIC unless revoked by the taxpayer with the consent of the Secretary.

Treas. Reg. § 1.1295-1(g)(1) provides that, for each year of a PFIC ending during a taxable year of a shareholder to which the shareholder has a QEF election in effect, the PFIC must provide the shareholder with a Statement containing the information required by that section.

Treas. Reg. § 1.1295-1(i)(2)(i) provides that the Commissioner, in the Commissioner's discretion, may consent to a shareholder's request to revoke a QEF election upon a finding of a "substantial change in circumstances."

Under Treas. Reg. § 1.1295-1(i)(2)(ii), a shareholder must request consent to revoke a QEF election no later than 12 calendar months after the discovery of the substantial change in circumstances that is the basis for the shareholder's request to revoke the QEF election.

Treas. Reg. § 1.1291-1(b)(2)(ii) provides that a PFIC is a pedigreed QEF with respect to a shareholder if the PFIC has been a QEF with respect to the shareholder for all taxable years during which the corporation was a PFIC that are included wholly or partly in the shareholder's holding period of the PFIC stock.

Under section 851, the term RIC means any domestic corporation which (i) at all times during the taxable year is registered under the Investment Company Act of 1940, as amended, as a management company or unit investment trust, or has in effect an election under such Act to be treated as a business development company, or (ii) which is a common trust fund or similar fund excluded by section 3(c)(3) of such Act (15 U.S.C. 80a-3(c)) from the definition of "investment company" and is not included in the definition of "common trust fund" by section 584(a).

## ANALYSIS

### Revocation of MTM Elections.

Section 1296(k) provides that a shareholder's MTM election for a PFIC remains in effect until the PFIC stock is no longer marketable stock or the Secretary consents to the revocation of the election, and Treas. Reg. § 1.1296-1(h)(3)(i) allows the Commissioner, in the Commissioner's discretion, to consent to a shareholder's request to revoke an election upon a "substantial change in circumstances." As an example, the regulation provides that a foreign corporation ceasing to be a PFIC may be such a substantial change in circumstances. However, there are no additional examples regarding what constitutes a substantial change in circumstances or guidelines for requests to revoke an MTM election.

By way of comparison, section 1295(b)(1) similarly provides that a QEF election can be revoked with the consent of the Secretary, and Treas. Reg. § 1.1295-1(i)(2) allows the Commissioner, in the Commissioner's discretion, to consent to a shareholder's request to revoke an election upon a "substantial change in circumstances." Just as with the revocation of the MTM election, there are no specific guidelines for what constitutes a substantial change in circumstances. However, Treas. Reg. § 1.1295-1(i)(2)(ii) requires that the shareholder must request consent to revoke its QEF election no later than 12 calendar months following the discovery of the substantial change in circumstances.

In order for Shareholders to have made a QEF election for FC, FC would have had to have issued Statements, as required under Treas. Reg. § 1.1295-1(g). However, FC did not have a practice of preparing or issuing statements to shareholders during Shareholders' taxable years that ended on Date 1, Year 4. As a result, Shareholders could not make QEF elections for FC for their taxable years that ended on Date 1, Year 4.

Subsequently, in Month X of Year 6, Shareholders discovered that FC had changed its policy and was now preparing and issuing statements to shareholders, enabling shareholders who are U.S. persons (who do not have MTM elections in place) to make QEF elections. The decision by FC to start issuing Statements was a change in the circumstances of FC that was outside the control of Shareholders. In addition, Shareholders requested consent to revoke the MTM elections less than 12 calendar months from discovering FC's policy changes. Therefore, based on the facts described in this letter, FC beginning to issue Statements constitutes a substantial change in circumstances for purposes of Treas. Reg. § 1.1296-1(h)(3)(i), and Shareholders' MTM elections for FC are revoked.

#### Year of Revocation.

Treas. Reg. § 1.1296-1(h)(3)(ii) provides that, when an MTM election is revoked by request, the revocation is effective for the first taxable year of the shareholder following the consent of the Commissioner to the revocation, unless otherwise provided by the Commissioner. In this case, Shareholders are requesting that their MTM elections with respect to the FC be revoked as of Date 1, Year 5 to be effective beginning Date 2, Year 5, which is the beginning of Shareholders' first taxable year which begins in an FC taxable year for which a Statement is available.

Shareholders' taxable year that began on Date 2, Year 5 and ended Date 1, Year 6 had already ended before the date of its request, but Shareholders' tax returns for that taxable year had not been filed and were not yet due. Under the general rule of Treas. Reg. § 1.1296-1(h)(3)(ii), the revocations of the MTM elections for FC would be effective for Shareholders' taxable year beginning Date 2, Year 6 and ending on Date 1, Year 7. Based on the facts described, and because Shareholders have not yet filed their tax returns for their taxable year ending on Date 1, Year 6, the revocations of Shareholders' MTM elections for FC are effective for the taxable year beginning Date 2, Year 5 and ending on Date 1, Year 6.

Holding Period

Pursuant to Treas. Reg. § 1.1296-1(f), for purposes of sections 1291 through 1298, if section 1296 applied to stock with respect to a shareholder for any prior taxable year, the shareholder's holding period in the stock is treated as beginning on the first day of the first taxable year beginning after the last taxable year for which section 1296 applied. In this case, because the MTM elections for FC are revoked as of the end of Shareholders' taxable year ending Date 1, Year 5, the taxable year ending Date 1, Year 5 is the last year for which section 1296 applied. As a result, Shareholders' holding periods, for purposes of sections 1291 through 1298, with respect to FC begin on Date 2, Year 5.

Pedigreed QEF Status.

Treas. Reg. § 1.1291-1(b)(2)(ii) provides that a PFIC is a pedigreed QEF with respect to a shareholder if the PFIC has been a QEF with respect to the shareholder for all taxable years during which it was a PFIC that are included, wholly or partly, within the shareholder's holding period for the PFIC stock. As discussed above, through the application of Treas. Reg. § 1.1296-1(f), for purposes of sections 1291 through 1298, Shareholders' holding periods with respect to the stock of FC begin on Date 2, Year 5. Shareholders have represented that if their ruling requests are granted, they will make QEF elections for FC with their tax returns for the taxable year beginning on Date 2, Year 5 and ending on Date 1, Year 6. Therefore, provided that Shareholders properly make QEF elections for FC with their tax returns for the taxable year beginning on Date 2, Year 5 and ending on Date 1, Year 6, FC would be a pedigreed QEF with respect to Shareholders.

Basis.

Section 1296(b) requires a shareholder who has made a MTM election to adjust its basis in its PFIC stock to increase it by the amount included in gross income under section 1296(a)(1) and decrease it by the amount deducted under section 1296(a)(2). These adjustments are not disregarded after a revocation of an MTM election.

**CONCLUSIONS**

Based on the information and representations submitted, Shareholders' requests to revoke their MTM elections for the taxable year ended Date 1, Year 5 are granted.

In addition, as a result of the revocations of Shareholders' MTM elections, we conclude that: (i) the revocations are effective as of Date 1, Year 5 and section 1296 ceases to apply to Shareholders beginning with Shareholders' taxable years beginning Date 2, Year 5; (ii) pursuant to Treas. Reg. § 1.1296-1(f), solely for purposes of sections 1291 through 1298, Shareholders' holding periods in FC are treated as beginning on Date 2, year 5; (iii) FC is a pedigreed QEF, within the meaning of Treas. Reg. § 1.1291-



1(b)(2)(ii) with respect to Shareholders, provided that Shareholders properly make QEF elections for FC for their taxable years beginning on Date 2, Year 5; and (iv) Shareholders' bases in FC include the basis adjustments made pursuant to section 1296(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/ Kristine A. Crabtree

Kristine A. Crabtree  
Senior Technical Reviewer, Branch 2  
(International)

cc: